

IT 95-81

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

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DEPARTMENT OF REVENUE      )
STATE OF ILLINOIS         )
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                           )   Docket:
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XXXXXX,                   )   James P. Pieczonka
                           )   Administrative Law Judge
                           )
Taxpayer(s)               )
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: James P. Pieczonka, Administrative Law Judge presided at a Rehearing of the above matter in Chicago, Illinois and presented the Department's prima facie case. Department of Revenue Exhibits 1-7 were admitted into the record. Taxpayer, XXXXX appeared pro-se as an Illinois licensed attorney and introduced Taxpayer Exhibits 1-5.

SYNOPSIS: The instant case arose from a non-field IL-941 audit of XXXXX a professional attorney corporation (hereinafter referred to as "XXXXX") due to the failure of the business to remit withheld taxes of its employees to the Department. The Deficiency covered the 1st, 3rd and 4th quarters of 1985, all four quarters in 1986 and the 1st quarter of 1987 in the amount of \$5,480.00. It was determined that Illinois 941 returns were not filed for the quarters in question and the business did not remit the taxes due to the Department. Therefore, a Notice of Deficiency was issued to Taxpayer A (hereinafter referred to as "TAXPAYER A") as a responsible officer of XXXXX pursuant to 35 ILCS 5/1002(d). The Deficiency was issued on July 9, 1991.

After Protest and a rehearing subsequent to a default hearing

(December 3, 1993), the issue was resolved in favor of the Taxpayer.

The issue presented for review is:

Whether Taxpayer was a responsible officer/person of XXXXX during the quarters in question, and thereby required to collect, truthfully account for and pay over the taxes due; and whether Taxpayer willfully failed to do so pursuant to Section 1002(d) of the Illinois Income Tax Act?

FINDINGS OF FACT:

1. XXXXX was a professional attorney corporation duly formed on March 21, 1983 and renewed on February 25, 1987. (Dept. Ex. No. 1) TAXPAYER A initially was the sole owner of the corporation. On July 18, 1985, TAXPAYER A sold a 20% interest in the corporation for \$25,000.00 to attorney Taxpayer B since TAXPAYER A was unable to handle all the administrative requirements of the business. (Tr. p. 9, 21)

2. Taxpayer B was a former employee and attorney appointed vice-president to assist in the administrative aspects of the practice since TAXPAYER A was incompetent to manage the expenses, payroll and taxes. (Tr. p. 11) Taxpayer B along with his secretary, managed the administrative aspects of XXXXX and prepared the payroll. (Tr. p. 22)

3. TAXPAYER A was under the care of doctors, hospitalized from time to time since 1985 and fully disabled and mentally impaired at least since 1985 due to drug dependency. (Tr. p. 14; Taxpayer Ex. No. 2)

4. TAXPAYER A was not paid a salary subsequent to April 30, 1986. (Tr. p. 16; Taxpayer Ex. No. 4) May 24, 1986 was the last day TAXPAYER A appeared at XXXXX due to his drug dependency and depression caused by his divorce. (Tr. p. 18; 25) As of September 30, 1986, TAXPAYER A was not reported as an employee of XXXXX on the IL-941 return for said quarter due to his mental disability, inability to work and absence from XXXXX (Taxpayer Ex. No. 4; Tr. p. 15)

5. XXXXX caused to be prepared an IL-941 return for the 3rd quarter of 1986 but did not remit the taxes due. The IL-941 indicated that it was signed by TAXPAYER A, however, he contends that his signature was forged.

(Tr. p. 18) TAXPAYER A admitted that he signed documents prepared by Taxpayer B during the quarters in question, however, due to his mental disability he did not know what he was signing. (Tr. p. 26; Dept. Ex. No. 3)

6. The operations of XXXXX closed without the knowledge of TAXPAYER A sometime in 1st quarter of 1987 during a period when he was hospitalized. (Tr. p. 18)

7. The signatories on the operating account of XXXXX were TAXPAYER A prior to July of 1985 and TAXPAYER A and Taxpayer B subsequent to July 18, 1985 (T. p. 23) XXXXX only maintained an operating account and a client fund escrow account. (Tr.p. 24)

8. On July 9, 1991, the Department issued a Notice of Deficiency to TAXPAYER A pursuant to Section 1002(d) of the IITA regarding the unpaid withheld taxes of XXXXX for the 1st, 3rd and 4th quarters of 1985, all four quarters in 1986 and the 1st quarter of 1987 in the amount of \$5,480.00. (Dept. Ex No. 2)

7. On July 15, 1991 TAXPAYER A filed a timely Protest to the Notice of Deficiency. He contended that he did not willfully fail to remit withheld taxes to the Department during the quarters in question due to his disabled mental state from alcohol and drug dependency since 1985. (Dept Ex. No. 3; Taxpayer Ex. No. 2.)

8. On December 3, 1993, a hearing was held and neither TAXPAYER A nor an attorney record appeared to rebut the Department's prima facie case. Consequently, a default order was entered. TAXPAYER A filed a timely request for Rehearing on June 21, 1994. (Dept. Ex. No. 5; Tr. p. 6) A rehearing was held on August 10, 1994 in the Department's Chicago office. (Dept. Ex. No. 6)

9. At the hearing, TAXPAYER A appeared pro-se and offered Taxpayer Exhibits 1-4 and his testimony to rebut the Department's case. TAXPAYER A admitted that the computation of the deficiency amount was correct,

however, his position was that he did not willfully fail to remit the withheld taxes of XXXXX because of his incompetence due to an alcohol and drug dependency since 1985. TAXPAYER A's testimony was corroborated by psychiatric and medical reports for hospitalization and treatment for drug dependency during the quarters in question. (Taxpayer Ex.'s 1-4)

CONCLUSIONS OF LAW: The Administrative Law Judge finds that TAXPAYER A has offered sufficient evidence to rebut the Department's prima facie case as to his willful failure to remit withheld taxes to the Department. Consequently, the Notice of Deficiency must be withdrawn in its entirety.

Section 1002(d) of the Illinois Income Tax Act provides:

Willful failure to collect and pay over Tax. Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The penalties provided under subsections (a) or (b) shall not be imposed for any offense to which this subsection applies. For purposes of this subsection, the term "person" includes an individual, corporation or partnership, or an officer or employee of any corporation (including a dissolved corporation), or any member or employee of a partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

35 ILCS 5/1002(d).

To be liable for penalties under Section 1002(d):

- (1). The taxpayer must be found to be responsible as an officer or person to collect and remit the withheld taxes; and
- (2). The failure to remit must be willful.

The Notice of Deficiency issued in this case is prima facie correct so long as its proposed assessment meets some minimum standard of reasonableness, *Vitale v. The Illinois Department of Revenue*, 118 Ill. App. 3d 210, 454 N.E. 2d 799, 73 Ill. Dec. 702 (1983). In order to overcome the prima facie correctness, the Taxpayer has the burden of presenting competent evidence that the proposed adjustments are incorrect, *Masini v. Department of Revenue*, 60 Ill. App. 3d 11, 376 N.E. 2d 324 (1978).

In the instant case the subject Notice of Deficiency was issued

subsequent to a non-field audit of the business. TAXPAYER A filed a Protest contending that he did not willfully fail to remit said taxes due to his impaired mental condition from alcohol and drug dependency during the quarters in question.

The record showed that TAXPAYER A was the majority shareholder of XXXXX. He was a signatory on the operating account of XXXXX and executed IL-941 returns and some checks in payment of creditors during the quarters in question. Consequently, TAXPAYER A was a responsible officer of XXXXX. Also, merely delegating his responsibilities to bookkeeping employees or other officers, such as Taxpayer B, does not absolve him of being a responsible officer of XXXXX.

Having met the responsibility test of Section 1002(d), the issue of willfulness must be addressed. TAXPAYER A contends that he did not have knowledge of the delinquent withheld taxes for the quarters in question, did not know what documents or checks he signed and had no involvement at all with XXXXX subsequent to May 24, 1986 due to his mental disabilities related to alcohol and drug dependency. TAXPAYER A'S contentions were corroborated by medical and psychiatric records for hospitalization and treatment during the quarters in question.

The Seventh Circuit has held willful conduct denotes intentional, knowing and voluntary acts. *Monday v. U.S.*, 421 F. 2d. 1210 (7th Cir. 1970). The action must be voluntary, conscious and intentional to be deemed willful. *Dunham vs. U.S.* 301 F. Supp. 700 (D.C. Conn. 1969).

On this record, TAXPAYER A, due to his mental incapacities from substance abuse, had no conscious, intentional or knowing ability to ascertain what responsibilities he had to XXXXX or what was occurring from time to time, therefore, his conduct was not willful.

Courts have ruled in favor of taxpayers that were disabled due to alcoholism or other chemical dependencies. In *Chandler Jr. v. Commissioner*, 60 TCM 448 (1990), Taxpayer was experiencing severe blackouts

up until the time of his final hospitalization. Notwithstanding his alcoholism and blackouts, he would appear to function rather normally but without any recollection as to what had happened. Taxpayer was in a "mental quagmire" for a number of years. The court held that the taxpayer's mental intent element to establish fraud was not present to impose penalties against him.

In *Hollman v. Commissioner*, 38 TCM 251 (1962), the court refused to find fraud when psychiatric evidence presented at trial established that petitioner suffered from severe psychosis rather than a neurosis or milder emotional disturbance. Also, in *S.C. Yokum v. Commissioner*, 50 TCM 906 (1985), the court addressed the abatement of a fraud penalty for a taxpayer that had overcome a drug habit, but upheld the penalty because the record contained no evidence of any psychiatric treatment or hospitalization.

On this record, although the issue is "willfulness", not fraud, the case law is analogous. TAXPAYER A has offered sufficient evidence in the form of testimony and documentary evidence to rebut the Department's case as to willfulness. TAXPAYER A'S alcohol and drug dependency illness during the quarters in question prevented him from making rational, informed and voluntary decisions not to remit the taxes due. Similar to *Chandler*, TAXPAYER A acted normal at times to carry on his practice, however, he could not recollect or comprehend what his responsibilities were during the quarters in question. Likewise, as in *Hollman*, the evidence showed that TAXPAYER A had relatively no involvement in the financial functions of XXXXX and required medical and psychiatric treatment and hospital confinement due to his substance abuse during the quarters in question. Due to his condition, he lacked the mental intent to willfully fail to remit the subject withheld taxes. Consequently, the Notice of Deficiency should be withdrawn.

RECOMMENDATION: The Administrative Law Judge recommends to the Director of Revenue that TAXPAYER A was a responsible officer of P. C. but did not willfully fail to remit said taxes to the Department for the

quarters in question. Therefore, the Notice of Deficiency must be withdrawn in its entirety.

James P. Pieczonka
Administrative Law Judge

Date